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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of The Air Force

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Air Force's Progress In Implementing The Federal Managers' Financial Integrity Act

ORIGINAL

GAO reviewed 23 federal agencies' continuing efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse in the federal government through annual agency assessments of internal controls and accounting systems and correction of systems' weaknesses.

This report focuses on the Air Force's progress and efforts to correct identified weaknesses in its internal controls and accounting systems and efforts to improve its assessment program.

GAO/NSIAD-85-151
SEPTEMBER 27, 1985

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

B-216946

The Honorable Verne Orr
The Secretary of the Air Force

Dear Mr. Secretary:

This letter presents the results of our review of the Air Force's continuing efforts to implement and comply with the Federal Managers' Financial Integrity Act (FIA) of 1982 [31 U.S.C. 3512(b) and (c)]. We sought to assess (1) the Air Force's progress in improving internal controls and accounting systems' compliance evaluations and (2) the adequacy of the basis for the Air Force's 1984 letter to the Secretary of Defense which stated that the objectives of the act had been met. We found that the Air Force has made progress in strengthening its internal controls. Nevertheless, because significant deficiencies persist, it does not have an adequate basis for determining whether Air Force systems of internal accounting and administrative controls, taken as a whole, fully comply with the act's requirements.

In addition to making a comprehensive accounting systems inventory, the Air Force needs to improve (1) performance and documentation of internal control reviews (ICRs), (2) coverage of automated data processing general and application controls, (3) quality assurance reviews, and (4) evaluation of accounting systems in operation. If implemented properly, we believe these improvements could significantly enhance Air Force's future basis for determining the overall status of its internal controls and for reporting whether or not the requirements of the act have been met.

FIA REQUIREMENTS

The Department of Defense's (DOD's) implementing instructions require each component to submit two annual reports to the Secretary of Defense. The instructions require one report to state whether systems of internal accounting and administrative controls, taken as a whole, fully comply with the act's requirements. The act requires that controls be established in accordance with the Comptroller General's standards and provide reasonable assurances that (1) obligations and costs comply with law, (2) assets are safeguarded against waste, loss,

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unauthorized use, or misappropriation, and (3) revenues and expenditures are properly recorded and accounted for. Any material control weaknesses, along with plans and schedules for their correction, must also be reported if controls do not fully comply with the act's requirements. The second report must state whether accounting systems conform to the principles, standards, and related requirements prescribed by the Comptroller General (hereinafter referred to as the Comptroller General's requirements). Appendix I contains the objectives, scope, and methodology of our review, and appendix IV is a glossary defining terms used in this report.

THE AIR FORCE'S REPORT ON INTERNAL CONTROLS AND ACCOUNTING SYSTEMS COMPLIANCE

In 1983 the Air Force reported five material internal control weaknesses and six accounting systems that did not conform to the Comptroller General's requirements. Moreover, the Air Force reported it had reasonable assurance that its systems of internal accounting and administrative controls could adequately detect and prevent fraud, waste, and abuse of resources. In 1984 the Air Force again reported that its systems of controls were in compliance with the act, and reported seven material weaknesses (five are repeats from last year) and three nonconforming accounting systems.

Two of the seven Air Force reported weaknesses were in Foreign Military Sales (FMS). According to its own analysis of FMS, the Air Force lacks adequate controls to assure (1) the proper billing of all applicable costs and surcharges and prompt reporting of deliveries and (2) accurate and timely close out of cases. The other five weaknesses cited in your report were

- --inadequate competition and uneconomical buying quantities increased spare parts costs;
- --controls which were inadequate because they could neither identify, report, nor prevent cost growth in weapon system acquisition;
- --audit trails for certain payroll systems were incomplete;
- --controls which allowed the disposal of some assets applicable to current weapon systems; and
- --administrative controls which did not generally require the evaluation of a contractor's quality control system as part of normal contract administration duties for service contracts.

These last two weaknesses were newly reported this year.

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PROGRESS IN CORRECTING WEAKNESSES AND BRINGING ACCOUNTING SYSTEMS INTO CONFORMANCE

The Air Force has made progress toward correcting the material weaknesses disclosed during 1983 and has plans to correct the new weaknesses reported in 1984. It has also acted to correct other less significant control weaknesses identified by Air Force major commands and separate operating agencies during the 1983 and 1984 evaluation processes. Further, the Air Force made progress correcting accounting system deficiencies and in conforming its accounting systems with the Comptroller General's requirements. The Secretary of the Air Force stated in the year-end report that FIA has made managers more aware of their responsibility to maintain effective internal controls.

Progress in correcting material weaknesses reported in 1983

The Air Force worked to correct the five material weaknesses reported in 1983 to the Secretary of Defense. We reviewed the status of the Air Force's corrections in FMS and spare parts procurement--two functional areas containing three of these five material weaknesses. In our opinion, these problems are complex and the solutions will require years of effort. The following summarizes the results of our review; appendix II provides more detail.

Foreign military sales

As of April 1985, the Air Force was managing over 4,270 FMS cases, involving sales of roughly $64 billion to about 75 countries or international organizations. Several years before the Air Force began implementing the FIA, various oversight agencies had cited shortcomings in this program.

Air Force officials said that in 1984 Air Force managers emphasized billing all applicable costs and reporting deliveries promptly. Specifically, they modified procedures to clarify codes and pricing policies and developed a plan to create an overall Air Force FMS management information system. They also modified procedures to ensure timely delivery reporting and developed a plan to automate reporting within this information system.

Regarding case closure, the Air Force stated in its year-end report that improvements strengthened existing prohibitions against extending cases unreasonably and emphasized strict enforcement against extending cases.

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The Air Force expects the FMS problem areas will be substantially improved by July 1987. However, the long-term solution to the billing and delivery reporting problem depends on developing and implementing the FMS management information system, which is funded through the conceptual design phase. The information system's implementation and integration is estimated to be completed by the end of fiscal year 1988.

Spare parts procurement

The Air Force's 1984 report to the Secretary of Defense stated that inadequate competition and uneconomical buying quantities are major problems in spare parts acquisition. The high prices paid for spare parts led to a series of congressional hearings and media coverage which alerted the public and moved senior DOD and Air Force officials to action. This problem is not unique to the Air Force--parts pricing problems have also been reported by the other services.

An Air Force study issued in November 1983 identified 68 areas where major reforms could be made in how the Air Force buys spare parts and made 178 specific recommendations. During 1984, the Air Force reported that 89 of the 178 recommendations were implemented. These 89 recommendations are designed to improve spare parts procurement by establishing Competition Advocacy Offices in Air Force buying activities, establishing Spares Acquisition Support teams, consolidating requirements, and ensuring that employees throughout the acquisition system understand new competition procedures and challenge items which appear to be incorrectly priced.

The Air Force is projecting that by the end of fiscal year 1985, the remaining 89 recommendations will be implemented. It does caution, however, that the success of many long-term recommendations requires changing DOD regulations and public law.

Progress in correcting other weaknesses disclosed in 1983

In addition to the five material weaknesses reported to the Secretary of Defense by the Secretary of the Air Force in 1983, Air Force major commands and separate operating agencies reported 44 other weaknesses to Headquarters, Air Force. According to these commands and agencies, 23 of these weaknesses were corrected during 1984 and actions were planned to correct the remaining 21. Some examples of corrective actions taken are:

--The Air Force Military Personnel Center has planned an interface between the Real-Time Automated Personnel Identification System and the Defense Enrollment Eligibility

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Reporting System to begin in early 1985 to improve patient eligibility verification procedures. This interface will allow base personnel offices to add or update service members and their dependents eligibility status for medical and other services (exchange, commissary, etc.,) directly into the Defense Enrollment Eligibility Reporting System. This will provide medical treatment facilities current patient eligibility data. Also, a pertinent regulation was being revised to improve readability and reduce misunderstanding of entitlement policies and procedures.

--The Air Force Office of Special Investigations reemphasized special investigation inspection, training, and staff visits to ensure that foreign liaison gifts were inventoried and documented. Air Force Regulation 124-3, Fiscal Procedures for Special Investigations, was changed to require an independent inventory of foreign liaison gifts twice yearly.

Progress in correcting weaknesses disclosed during the 1984 evaluation process

During FIA's second year, numerous internal control problems were identified and corrected at major commands, separate operating agencies, and at base levels. Some of the corrective actions were included as examples of improvements to internal controls in your year-end report to the Secretary of Defense. Two examples are:

--Improved contract review, approval, and award process in one command by spelling out legal review thresholds in office instructions, and prepared acquisition plans which included milestones for accomplishing actions from receipt of requirement to contract award.

--Improved controls over the use of government vehicles by (1) increasing training and orientation of vehicle authorization board members in one command and (2) developing a computer program for better tracking vehicle mileage and vehicle usage in another command.

Progress in bringing accounting systems into conformance

The Air Force reported progress toward bringing its accounting systems into conformance with the Comptroller General's requirements. In the 1984 FIA report, the Air Force stated that a number of accounting system deficiencies were corrected and two nonconforming systems were brought into

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conformance. It reported 25 of its 28 accounting systems in substantial conformance with the Comptroller General's requirements.[1] We believe the Air Force reported all of its known accounting system problems.

Status of accounting systems

The three systems reported as not conforming, along with their major accounting deficiencies, were:

--The General Accounting and Finance System. This is an accrual system that encompasses all Air Force assets, liabilities, income, and expense, and serves general accounting and finance requirements at more than 120 Air Force field locations. It also supports requirements for more than 50 non-Air Force federal agencies within and outside DOD. The system accounted for nearly $114 billion in Air Force and DOD appropriations during fiscal year 1984.

The annual statement reported a need for depreciation accounting and total costing, accounting for and reporting contingent liabilities, property accounting, and a need to improve posting to the general ledger. The need for accurate general ledger account balances is especially important--it serves as a high level of control over the integrity of data in the systems and subsystems and the reliability of financial reports. In this regard, the Air Force system lacks a coding structure which would ensure that the general ledger account balances are generated from source documents.

--The Central Procurement Accounting System. This is an Air Force Logistics Command System, which with the Financial Inventory Accounting and Reporting System, is used to account for end items of equipment required to support weapon systems and for repairable components of support equipment and complete weapons. This system accounted for approximately $10 billion in Air Force fiscal year 1984 appropriations.

The Air Force's annual statement reported a need to record accrued expenditures and to better account for government-furnished material. We recently testified

[1]In 1983 the Air Force reported it had 29 accounting systems. During 1984, one system--the Defense Integrated Financial System for FMS--was transferred to the Defense Security Assistance Agency, that now reports on its status.

before the Subcommittee on Legislation and National Security, House Committee on Government Operations, that the military services, including the Air Force, lack basic accounting systems control over an estimated $14 billion in government-furnished material. We also noted that this condition has existed for many years.

--The Retiree/Annuitant Pay System. This is a centralized system that provides pay, accounting, and reporting for military retirees and annuitants, and also provides data to the General Accounting and Finance System. Payments made by the system in fiscal year 1984 amounted to nearly $6.2 billion.

The Air Force annual statement only listed a need to develop a system upgrade. Problems cited by Air Force officials include incomplete audit trails, inadequate interfaces with other systems, and lack of accrual accounting.

Corrective actions taken on deficiencies reported in 1983

In 1983 the Air Force reported that six of its accounting systems did not conform with the Comptroller General's requirements. The Air Force reported that two of these nonconforming systems--the Air Force Stock Fund and the Joint Uniform Military Pay System--were brought into conformance during 1984 as a result of corrective actions taken. Corrective actions are planned which will bring the three remaining nonconforming systems into conformance by 1991. The sixth nonconforming system was the Defense Integrated Financial System for FMS, which is no longer reported on by the Air Force. The Air Force's corrective actions taken and planned are discussed in appendix III.

PROGRESS AND PROBLEMS IN DETERMINING THE STATUS OF INTERNAL CONTROLS AND ACCOUNTING SYSTEM CONFORMANCE

In deciding whether an agency has an adequate basis for determining that its internal control systems, taken as a whole, meet the requirements of the act, we believe the agency head must consider the (1) significance of the weaknesses disclosed, (2) status of corrective actions, (3) comprehensiveness and quality of the management control evaluation work performed, and (4) extent to which accounting systems conform to the Comptroller General's requirements.

We believe the Air Force has met the first two criteria. Prior sections of this report have shown that the Air Force has done a creditable job of disclosing material weaknesses and has

made progress toward correcting them. However, we believe the comprehensiveness and quality of the Air Force's internal control and accounting system evaluation program has not matured to the point that it provides an adequate basis to conclude that the requirements of the act have been met.

In our report[2] last year, we identified several improvements the Air Force needed to make to improve the comprehensiveness and quality of various elements of its internal control and accounting systems compliance evaluation process. We reported that

--guidance and training on how to perform and document vulnerability assessments (VA) and ICRs needed to be improved,

--segmentation and VA phases needed to be separated and improved,

--ICRs needed to provide better coverage of automated data processing (ADP) controls,

--material weaknesses needed to be explained more specifically in the annual report,

--a comprehensive inventory of its accounting systems and system segments was needed, and

--its accounting systems in operation needed to be tested.

During 1984 the Air Force made some of the improvements we suggested. It separated and improved the segmentation and VA phases, provided some training and detailed guidance on how to perform and document VAs, ICRs, and accounting system reviews, and was more specific about the material weaknesses reported this year. However, four areas still need improvement: (1) documenting and/or performing VAs and ICRs adequately (testing internal controls for compliance), including conducting more effective quality assurance evaluations of ICRs, (2) addressing ADP general and application control areas adequately, (3) completing a comprehensive accounting systems inventory, and (4) testing accounting systems in operation.

Better performance and documentation of ICRs is still needed

The Air Force took steps to improve its ICRs by training program and functional managers, and issuing detailed guidance

[2]Department of the Air Force's First-Year Implementation of the Federal Managers' Financial Integrity Act (GAO/NSIAD-84-93, May 1, 1984).

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on how to perform and document a review. Our evaluation of completed ICRs disclosed that some were not properly completed because of performance and documentation problems. We also found quality assurance reviews were ineffective because they did not detect or prevent these problems. We reviewed 24 ICRs and concluded that 15 (63 percent) were inadequately documented, and 8 (33 percent) were not adequately done because internal controls were not compliance tested.

Three of the reviews we evaluated were properly completed and documented. We believe these reviews were adequate because the reviewers used and followed the "how to" guidance the Air Force issued.

The Air Force established a training program for its program and functional managers--about 60 of whom had been trained. These managers were then to train the individuals performing ICRs. However, we found that the majority of the base-level ICR reviewers, in the 24 cases we reviewed, were not adequately trained in how to perform an ICR. We believe they could have done a better job had they been adequately trained.

The Air Force Audit Agency also evaluated ICRs as part of its evaluation of the 1984 FIA program and found similar problems. The agency reported that systemic reviews were not always performed, compliance review methodology was not always documented, quality assurance was not provided over major command and base-level reviews, and base-level reviewers were not trained on review methodology and documentation requirements.

The Air Force has taken steps to address these problems. The fiscal year 1985 evaluation program guidance, issued October 30, 1984, made the following improvements:

--Directed that systemic reviews (see ICR steps 1 through 4 on page 30) be performed at the Air Force staff level for Air Force-directed review topics, and at the major command/separate operating agency headquarters level for its directed topics.

--Defined documentation requirements more specifically by incorporating the documentation workbook from the DOD ICR training course.

--Assigned specific quality control responsibilities to the program managers for assuring documentation standards and to the functional managers for the accuracy and adequacy of the review content.

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Better consideration of ADP internal controls is still needed

The Air Force mission and many of its administrative and operational functions, such as personnel, payroll, supply, and command and control would be difficult to perform effectively without the aid of computers. The Air Force has the largest ADP budget in the federal government--its obligations for fiscal year 1984 for information technology were over $2 billion. Associated with the use of automation, are elements of risk which can increase chances for the occurrence of fraud, waste, and abuse. Internal controls can be used to identify and reduce these potential risks. It is therefore necessary to review and evaluate the functioning of ADP internal controls to ensure these risks are minimized and to provide an adequate basis to determine the status of the controls.

Last year we reported that better coverage of the Air Force's ADP controls was needed. In response, the Air Force issued supplemental ADP guidelines for ICRs in August 1984. However, the guidelines were received too late to be incorporated into the 1984 ICRs. Although the guidelines were late, Air Force commands were to evaluate ADP application controls and report the results to the Air Force Comptroller by October 15, 1984. Not all commands completed the evaluations by the deadline, some requested and got an extension. At least three, including the Logistics Command, a primary user of ADP, did not evaluate ADP controls at all.

We believe the guidelines were inadequate because they did not cover general controls such as software design, development or testing, data processing facility security, and hardware controls. As a consequence, the Air Force did not adequately assess ADP controls during the fiscal year 1984 evaluation process.

DOD recognized both the importance of ADP coverage in ICRs and the lack of such coverage by DOD components since the implementation of FIA. It established a task force which designed a guideline for all the military departments to use in ensuring that ADP internal controls were included in the FIA process. These DOD ADP Internal Control Guidelines were released too late to be used in the fiscal year 1984 ICRs. However, if adopted, their use should improve the Air Force's attention to ADP in the fiscal year 1985 ICRs. Use of the guidelines is not mandatory.

Comprehensive accounting system inventory and compliance testing of systems in operation are still needed

Last year we reported that the Air Force needed a comprehensive accounting systems' inventory, and needed to evaluate

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the accounting systems in operation to ensure that compliance efforts were comprehensive and supported the annual report. A comprehensive inventory is important to ensure that all accounting systems are identified and evaluated. Evaluating a system in operation is also important because it ensures that the system is working in accordance with the documented requirements.

The Air Force has improved its process for implementing section 4 of the act. Its fiscal year 1984 guidance for systems evaluations was more definitive and stringent. The Air Force increased accounting systems review coverage and set requirements for system and review documentation. The Air Force began reassessing its accounting system inventory and reduced fragmentation in its organization for implementing the act by merging the responsibility for internal control and accounting system evaluation guidance into one office. In addition, it has a corrective action tracking and follow-up system and target dates for completing corrective actions.

Despite the Air Force's progress, its accounting system evaluation program did not provide an adequate basis to assure, as stated in the Air Force's year-end report to the Secretary of Defense, that its accounting systems conform to the Comptroller General's requirements, or that its nonconforming systems satisfactorily support the Air Force's fiduciary and management accounting responsibilities.[3] The evaluation process was inadequate because (1) the Air Force did not have a complete inventory of systems, (2) most systems were not evaluated, (3) the systems that were evaluated were not adequately tested in operation, (4) internal ADP controls were not adequately covered, and (5) fiduciary and management responsibilities were not analyzed.

Accounting systems inventory not complete

DOD instructions require that a complete accounting systems inventory be developed and verified. The inventory should include all systems and system segments, which authorize, record, classify, and report on operations related to revenues, expenses, assets, liabilities, and equity. The Air Force's current inventory of 28 accounting systems is not complete. For example, one of the systems not included--the Acquisition Management Information System--disburses billions of dollars each year to defense contractors. It is very important that all of the Air Force's accounting systems presently excluded from the

[3]According to a DOD official, this statement means that the Air Force has adequate administrative and accounting control over appropriations made by the Congress, even in the systems which do not conform to the Comptroller General's requirements.

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official inventory be included so that they may be considered and scheduled for evaluation. This will provide the Air Force a better basis to determine whether all of its systems conform to the Comptroller General's requirements.

Accounting systems need to be evaluated before being reported in conformance

The Air Force plans to review its current inventory of 28 accounting systems over a 5-year period. In fiscal year 1984, the Air Force evaluated 7 of the 28 systems for conformance with the Comptroller General's requirements. Even though it only evaluated 7, the Air Force reported that 25 of its systems substantially conform to the Comptroller General's requirements, and that its nonconforming systems provide for fiduciary and management accounting. The Air Force based this determination on its evaluations, which did not include transaction testing, and the fact that professional audit services did not report any of the 25 systems as not conforming.

While the 5-year review cycle planned by the Air Force appears reasonable, we believe the Air Force should not report on a system's status of compliance until it has been evaluated. Without this evaluation, we believe the Air Force had an insufficient basis to conclude that those systems not evaluated conform to the Comptroller General's requirements.

Evaluations need to be improved

The Air Force did not test transactions of its systems as part of the 1984 evaluation program. The Air Force has adopted the position that testing does not add to the validity of the annual FIA statement because it does not add assurances beyond those already established in the design, development, and implementation of an accounting system. The Air Force stated that testing will only be done when other evidence is not available to substantiate accounting system conformance. For example, the evaluation of the Central Procurement Accounting System consisted of the reviewer completing a questionnaire containing the Comptroller General's requirements applicable to the system, based on his knowledge of that system. No testing of financial transactions was performed.

Our experience in reviewing systems frequently shows that documented system procedures may be adequate but in practice, procedures may not be properly performed. For example, in a report to the Secretary of Defense on pricing overhaul and repair services performed for foreign countries,[4] we estimated

[4]Improvements Needed in Pricing Overhaul and Repair Services Performed for Foreign Countries (GAO/AFMD-84-12, Dec. 12, 1983).

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that the Air Force underbilled West Germany about $456,000 for costs incurred for engine overhauls. This incident occurred because one of the commands did not follow its own accounting procedures for ensuring that all proper costs are charged. This example illustrates the need to test the system in operation to find out if system procedures are being performed in accordance with documented requirements.

To determine whether an accounting system conforms to the Comptroller General's requirements, it is necessary to review and test the system in operation. Although agency personnel may have extensive system knowledge, as noted above, we have found in the past that systems frequently operate differently than responsible officials believe them to be. Therefore, testing should be conducted on all critical areas of the system. Our glossary identifies what we consider to be adequate testing of accounting systems in operations (see p. 32).

In addition to the testing issue, the Air Force needs to improve its examination of ADP controls in accounting systems. During fiscal year 1984, the Air Force instructed its Data System Design Office to make an assessment of internal controls for portions of four automated data processing systems. Design Office personnel evaluated controls they are responsible for, such as system documentation, software security, and controls within the system design. The work was done at the Design Office only. Design Office personnel did not evaluate controls at other locations, such as data processing installations and base accounting and finance offices.

Adding further doubt about the Air Force's assertions on the adequacy of its accounting systems, is the statement that its nonconforming systems have financial control and reporting features that satisfactorily support the Air Force's fiduciary and management accounting responsibilities. The Air Force accumulated no evidence to support tha statement. Instead, it used language in its conformance statement that was suggested by a DOD memorandum. Before making such a statement, we believe the Air Force should conduct an analysis to ensure that its nonconforming systems satisfactorily support fiduciary and management accounting responsibilities.

In January 1985, the Air Force provided instructions to the field for reviewing accounting systems in fiscal year 1985. The new instructions provide for testing, and require the cooperation of functional and data automation personnel in performing the tests. In our future work, we will evaluate the adequacy of the new instructions.

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CONCLUSIONS

In our report on the Air Force's 1983 implementation efforts, we made suggestions and recommendations that we believed, if followed, would make the Air Force's year-end statement of reasonable assurance more meaningful. Because of the magnitude of the Air Force's programs, activities, and functions, it can be expected that differing opinions would exist on the adequacy of the basis for determining the status of internal controls. Certainly this judgment is difficult to make.

This report shows that the Air Force has improved its internal control systems, made progress toward correcting reported weaknesses, and improved its evaluation programs. Overall, we believe the Air Force has established the basic framework for an effective program. However, our review found that even with this framework and the Air Force's progress, more improvements are needed before it will have an adequate basis for determining that Air Force's internal controls, taken as a whole, comply with the requirements of the act. We found that internal control reviews are still not being adequately performed, and the Air Force's evaluation program needs to better consider ADP internal controls.

Regarding accounting systems, the Air Force made progress last year in correcting some reported weaknesses. However, we believe it had an insufficient basis for reporting 25 of its 28 accounting systems as substantially conforming with the Comptroller General's requirements, and that its systems satisfactorily support Air Force fiduciary and management accounting responsibilities. Our belief is based on the fact that the Air Force (1) did not have a comprehensive accounting systems inventory, (2) did not evaluate most of its accounting systems, (3) did not test its accounting systems in operation or adequately evaluate the accounting systems ADP components, and (4) did not analyze its fiduciary and management accounting capabilities in nonconforming systems.

RECOMMENDATIONS

We recommend that the Secretary of the Air Force not report that the Air Force's systems of internal accounting and administrative control, taken as a whole, meet the requirements of the act until the internal controls evaluation program is improved.

To form an adequate basis for determining that the requirements of the act have been met, we recommend that you direct the Comptroller, Air Force, to ensure that

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--managers who perform VAs and ICRs are adequately trained,

--ADP general and application control reviews are incorporated into ICRs,

--DOD ADP Internal Control Guidelines are included as part of the Air Force's guidance and approach for consideration and evaluation of ADP internal controls,

--responsible officials at all levels of the organization effectively perform their quality assurance responsibilities,

--an inventory of accounting systems is promptly completed, and

--appropriate manual and ADP accounting systems controls are tested in operation as an integral part of the evaluation process.

We further recommend that accounting systems not be reported in conformance with the Comptroller General's requirements, nor that nonconforming accounting systems satisfactorily support fiduciary and management accounting responsibilities until the Air Force's accounting systems have been adequately evaluated and tested in operation.

AGENCY COMMENTS AND OUR ANALYSIS

DOD provided official comments on the findings and recommendations in our draft report (see app. IV). DOD generally agreed with the facts in our report and agreed with our recommendation that the Comptroller take certain actions to improve the Air Force's internal controls and accounting systems evaluation programs. DOD stated Air Force had already implemented these actions. Specifically, the Air Force has provided enhanced training to program managers; included ADP general and application controls in the information systems functional area ICRs; included DOD ADP Internal Control Guidelines as part of the guidance and approach for evaluating ADP internal controls; completed a comprehensive inventory of its accounting systems; and sent additional testing instructions to all major commands.

However, DOD did not agree with our conclusions and related recommendations concerning the adequacy of the Air Force's basis for determining that its internal control systems, taken as a whole, met the requirements of the act and that accounting systems conformed with the Comptroller General's requirements.

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Disagreement on the basis for determining that requirements of the act have been met

DOD did not concur with our recommendation that the Secretary of the Air Force not report the Air Force systems of internal accounting and administrative control, taken as a whole, meet the requirements of the act until its evaluation program is improved. DOD believes that the Air Force program, as it currently exists, is adequate. DOD believes that the improvements the Air Force made during fiscal year 1984 enhanced the program's comprehensiveness and quality; and that the internal management control program, in conjunction with other management reviews, such as reviews of IG, audit, and investigative reports, and general internal self-inspection programs at the installation levels, does provide an adequate basis to determine that the requirements of the act have been met.

While we believe the Air Force has done a creditable job in disclosing material weaknesses and is making progress in correcting them, significant material weaknesses still need to be fully corrected. However, more importantly, the Air Force's evaluation program has not progressed to where we think it could be because of the evaluation problems we found. These same problems were found during our fiscal year 1983 evaluation. Further, the Air Force has three accounting systems that do not conform to the Comptroller General's requirements.

In order for Air Force's systems, taken as a whole, to provide the reasonable assurance required by the act, we believe Air Force must have a comprehensive evaluation program. Air Force must essentially do two things to meet the requirements of the act. First, it must ensure that internal control systems meet the Comptroller General's standards, which require that various control techniques within programs, functions, and activities be designed to cost-effectively achieve all important control objectives, and that control systems provide the means for preventing fraud, waste, and abuse. Second, it must verify that key controls are being systemically implemented and are operating as intended. If not, corrective actions should be taken and then tested to determine whether the weaknesses have been corrected.

DOD stated that the Air Force's internal management control program includes review of IG, audit, and investigative reports, and general self-inspection programs at the installation level. We agree that these sources of information on the effectiveness of controls are important and should be used. DOD's FIA regulations require that managers consider data from all sources (particularly from the audit community) when determining vulnerabilities, and as alternatives to conducting detailed internal

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control reviews. In this respect, DOD regulations are in accordance with FIA guidelines that were established jointly by OMB and by us in 1982. However, although IG, auditor general, internal audit, and our reviews may have detected particular instances of fraud, waste, or abuse, they rarely have the scope necessary to allow managers to determine the status of controls within entire functions or their organizations as a whole. In order to obtain these overall assurances, we believe agencies must do the two things outlined above.

We recognize that because of the magnitude of the Air Force's programs, activities, and functions, differing opinions could exist on the adequacy of the basis for determining the overall status of internal controls. Certainly such a judgment is difficult to make. However, considering all the information available to us, we continue to believe that the Air Force did not yet have an adequate basis to determine that its systems, taken as a whole, meet the requirements of the act.

Further, we recognize that the Air Force has already taken action to address specific recommendations we made on improving their internal controls and accounting systems evaluation programs. If implemented properly, we believe these improvements could significantly enhance the Air Force's future basis for determining the overall status of its internal controls and whether or not the requirements of the act have been met.

Disagreement on determining accounting systems conformance

DOD did not agree with our recommendation that the Air Force accounting systems not be reported as being in conformance, nor that nonconforming accounting systems satisfactorily support fiduciary and management accounting responsibilities until the accounting systems have been adequately evaluated and tested in operation. DOD stated that it believed the Air Force had sufficient basis to determine conformance and that all systems satisfactorily supported accounting responsibilities, adding that no evidence to the contrary has been found. It further stated that when a system is designed in accordance with existing requirements; exhaustively tested; maintained; reviewed periodically with acceptable to excellent results; and whose design has been previously approved by GAO, it should be considered in conformance until proven otherwise.

We believe that in order for an existing accounting system to be reported in conformance, an agency must adequately evaluate and test that system in operation. The nature and comprehensiveness of such testing may be influenced by the recency and extent of prior reviews and testing during the design phase or when the system was operating.

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We also believe that a statement regarding nonconforming systems supporting accounting responsibilities must be backed by an adequate evaluation, and not by the absence of reports to the contrary. The Air Force could not furnish any evidence that such an evaluation was made.

Although DOD did not agree with our recommendation, it did advise that the Air Force will comply with DOD guidance. This guidance will establish objectives, criteria, testing and documentation requirements for system evaluations. Further, DOD advised us that future component reports on accounting systems must indicate that conformance is based on transaction testing. We believe that if this guidance is implemented properly, the Air Force will satisfy the intent of our recommendation.

. . . . .

As you know, 31 U.S.C. §720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committee on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen of the above committees; the Chairmen of the House and Senate Committees on Armed Services, and the Budget; the Director, Office of Management and Budget; and to the Secretary of Defense.

Sincerely yours,

Frank C Conahan

Frank C. Conahan
Director

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ABBREVIATIONS

ADP	Automated Data Processing
AFMAG	Air Force Management Analysis Group
DOD	Department of Defense
FIA	Federal Managers' Financial Integrity Act
FMS	Foreign Military Sales
GAO	General Accounting Office
ICR	Internal Control Review
OMB	Office of Management and Budget
VA	Vulnerability Assessment

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OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to

--determine whether actions taken under the act have improved internal controls and accounting systems,

--evaluate the Air Force's progress in implementing its program for evaluating systems of internal control and accounting, and

--assess the adequacy of the basis for the Air Force's reporting that the objectives of the act had been met and that accounting systems do or do not conform with the Comptroller General's requirements.

The review was done from July 1984 through June 1985 at Air Force Headquarters in the Pentagon, Washington, D.C., with limited work at two nearby installations--Bolling and Andrews Air Force Bases. Work, primarily on ICRs, was also performed at the following major commands and installations throughout the United States:

Major Commands	Installations within Commands
Air Force Logistics Command, Wright Patterson Air Force Base	Kelly Air Force Base Robins Air Force Base
Air Training Command, Randolph Air Force Base	Goodfellow Air Force Base Keesler Air Force Base
Strategic Air Command, Offutt Air Force Base	Beale Air Force Base Grissom Air Force Base
Military Airlift Command, Scott Air Force Base	Travis Air Force Base Pope Air Force Base

We also performed work at the Air Force Accounting and Finance Center, located at Lowery Air Force Base; and at the accounting and finance offices at the installations listed above, except for Goodfellow Air Force Base.

In reviewing the Air Force's second annual assurance letter, we considered problems identified in the internal control and accounting system evaluation programs of the agency components, as well as those identified in our prior reports. We limited our evaluation to an examination of the Air Force's program for determining the adequacy of internal controls and accounting systems compliance. We did not independently evaluate the adequacy of the Air Force's internal control systems

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or whether its accounting systems comply with the Comptroller General's requirements.

During the review, we coordinated with the Air Force Inspector General and the Air Force audit agency, using the results of their work when possible. Our review was made in accordance with generally accepted government auditing standards.

We interviewed responsible Air Force officials at various levels on the air staff and in the FIA program office, and at the command and base levels, including program and functional managers. We also examined:

--Guidance, instructions, vulnerability assessments, ICRs, and other records which documented the internal control evaluation process.

--A sample of 23 VAs and 24 ICRs.

--The status of corrective actions taken by the Air Force this year, with primary emphasis on the FMS and spare parts procurement material weaknesses. However, we did not evaluate the effectiveness or appropriateness of planned actions because time did not permit the in-depth analysis required to make such an assessment.

--The progress made toward increasing the consideration of ADP controls during the evaluation process.

--The progress made toward bringing the Air Force's accounting systems into conformance with the Comptroller General's principles, standards, and related requirements.

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CORRECTIVE ACTIONS TAKEN AND PLANNED ON THE AIR FORCE'S REPORTED INTERNAL CONTROL WEAKNESSES

The Air Force reported five known material weaknesses last year and seven this year. Five of the seven are repeats from last year and two are new. The Air Force made progress toward correcting the earlier weaknesses and has developed plans to correct this year's newly reported ones.

PROGRESS IN CORRECTING LAST YEAR'S REPORTED MATERIAL WEAKNESSES

Last year the Air Force reported five material weaknesses requiring corrective action:

--FMS controls were not fully adequate to ensure proper billing of all applicable costs and surcharges, or that deliveries to FMS customers were promptly reported so that final billing could be made.

--FMS controls were not fully adequate to ensure timely and accurate close out of FMS cases.

--Inadequate competition and uneconomical buying quantities adversely affected the Air Forces' spare parts costs.

--Controls to identify, report, and help prevent cost growth in weapon system acquisition were not adequate.

--Audit trails for certain pay systems were not complete.

We reviewed the Air Force's efforts to correct material weaknesses related to FMS and spare parts acquisition and found that the Air Force is making progress in these areas. We believe the final solution to these problem areas is a long-term effort and depends, at least in part, on corrections that must be made by DOD.

Foreign military sales

Over the past several years, reports by various oversight agencies cited shortcomings in the FMS program and alerted both DOD and Air Force officials to program weaknesses before the Air Force began its efforts to implement FIA. As of April 1985, the Air Force was managing over 4,270 FMS cases, which involved sales of roughly $64 billion to about 75 countries or international organizations.

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In November 1982, a DOD FMS Financial Management Improvement Program was established by direction of the House Committee on Appropriations, for a 3-year period, to address shortcomings in DOD's FMS operations. It has been extended through fiscal year 1986. The Air Force established its own program--FMS Improvement Program--in December 1983 and is working in liaison with the DOD effort.

A task force, chartered by the Air Force Vice Chief of Staff, working from February to November 1983, reviewed the Air Force's FMS management procedures and capabilities, identified problem areas, and reported 116 recommendations to improve the FMS management process. These recommendations were later combined into 104. In December 1983, the Air Force Comptroller established an FMS Steering Group to manage the implementation of these recommendations.

At the direction of the Steering Group, an FMS Improvement Program corrective action plan was developed. The plan defines 15 major program areas, identifies specific problems within the areas, and indicates recommendations intended to improve them.

The Air Force developed the FMS corrective action plan shortly before reporting FMS as two of the five Air Force-wide material weaknesses in last year's annual assessment letter to the Secretary of Defense. This year, the Air Force again reported FMS as material weaknesses, but was more specific regarding the problems. It reported that the most significant FMS problems are that the

--controls are not adequate over FMS to ensure proper billing of all applicable costs and surcharges, or that deliveries to FMS customers are not promptly reported so that final billing can be made and

--controls are not adequate to ensure the timely and accurate close out of cases.

The corrective action plan was approved in March 1984 by the Air Force FMS Executive Group, which consists of five generals who meet periodically to review FMS Improvement Program progress. Offices of primary responsibility and action officers have been assigned for each recommendation, along with taskings and milestones.

Twenty of the recommendations related to billing and delivery reporting, while 21 related to case closure and reconciliation. The remaining 63 covered other FMS areas, such as case management and supporting discipline responsibilities.

In the FMS Improvement Program's first year of existence, the Air Force made progress towards improving its FMS process.

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By December 31, 1984, 21 recommendations had been closed, of which 2 related to billing and delivery reporting and 7 related to case closure and reconciliation.

The Air Force's reported accomplishments in the billing and delivery reporting area during fiscal year 1984 include

--modifying and strengthening code usage procedures, pricing policies, and delivery reporting procedures;

--developing a plan to create an overall FMS management information system, called the Case Management Control System;

--holding training courses at 20 field locations on various aspects of FMS pricing and delivery reporting; and

--developing a plan to automate the delivery reporting process as part of the Case Management Control System.

The Air Force reported that future action will center around further development of the Management Information System that will integrate accounting, billing, logistics, and the procurement process. The Management Information System is funded through the conceptual design phase. The Air Force estimates that complete integration of the delivery reporting process with the other processes will take place by the end of fiscal year 1988. The Management Information System is the key to correcting the FMS weaknesses. Consequently, as the Air Force points out in its assurance letter, weaknesses will remain until this system is implemented.

The Air Force's reported accomplishments in the case closure and reconciliation area during fiscal year 1984 include:

--Chartering a reconciliation committee to work FMS case closure and reconciliation problems. This committee has set goals, developed new procedures, and monitored reconciliation efforts at several commands.

--Strengthening and strictly enforcing existing prohibitions against extending FMS cases unreasonably, which should permit earlier case closure.

The Air Force states that future actions are planned to intensify closure and reconciliation efforts of older cases and to adopt administrative adjustment procedures to bring cases into balance. It also plans to continue reconciliation teams and to adopt a new reconciliation format in the Air Force Logistics Command. The Air Force is projecting that the FMS problem areas will be substantially improved by July 1987.

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Spare parts

The Air Force is in the process of reforming its spare parts process, including requirements determination, acquisition, and disposal. As part of this reformation, it is addressing the spare parts acquisition material weakness identified in last year's annual assurance letter and in this year's assurance letter. As stated in this year's letter, the problem is "inadequate competition and uneconomical buying quantities adversely affected Air Force spare parts cost." To correct the weakness, the Air Force is relying primarily on the implementation of recommendations developed from studies on spare parts acquisition and spare parts requirements. These studies are (1) the Air Force Management Analysis Group Study on Spare Parts Acquisition and (2) the Corona Require: An Analysis of the Aircraft Replenishment Spares Acquisition Process.

During the fiscal years 1979 to 1982, the Air Force investigated the causes for the apparent sharp increase in prices paid for certain spare parts. A series of internal studies and investigations, beginning in 1979, resulted in a public disclosure late in 1982 of an Air Force Logistics Command report on engine spare parts price increases. In addition, the Air Force had underestimated its fiscal year 1982 spare parts requirements by over $800 million. These disclosures led to a series of congressional hearings and media coverage, which highlighted the issue to the general public. The publicity culminated in the Air Force Management Analysis Group and Corona Require studies and generated high visibility among senior DOD and Air Force officials.

The Air Force Management Analysis Group Study on Spare Parts Acquisition, released in November 1983, identified 68 areas in which major reforms could be made regarding how the Air Force buys its spare parts. The report contained 178 recommendations aimed at improving the spares acquisition process. We estimate that about 42 of the 68 problem areas and 114 of the 178 recommendations relate directly to inadequate competition and uneconomical buying quantities. The other 26 problem areas and 64 recommendations appear to relate indirectly to these issues, covering such areas as pricing and resources.

To ensure that the recommendations were given serious consideration, the Air Force established a General Officer Steering Committee, chaired by the Deputy Chief of Staff for Logistics and Engineering and comprised of officers from the air staff, logistics command, and systems command. The Committee meets monthly to review progress made by the commands and agencies involved in spares acquisition and approve the closure of recommendations. Closure means a recommendation has been either implemented, considered fully and determined not beneficial or

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not practical, or partially implemented with remaining actions still being monitored by the Air Force. The Deputy Chief of Staff for Logistics and Engineering provides progress reports semiannually to the Secretary of the Air Force. The Air Force has established milestones as guidelines for monitoring the progress made in implementing these recommendations.

In this year's annual assurance letter, the Air Force reported that 89 of the 178 recommendations had been implemented and that these implemented recommendations have had a positive effect on spares acquisition through the (1) establishment of Competition Advocacy offices throughout the Air Force buying activities, (2) establishment of Spares Acquisition Support Teams, (3) consolidation of requirements, and (4) assurance that employees at all levels of the Air Force acquisition system are fully aware of new procedures to increase competition and challenge items apparently incorrectly priced. According to a program official, the Air Force expects to close most of the remaining 89 recommendations by the end of fiscal year 1985. Recommendations anticipated to remain open at that time include those pertaining to data processing and to multiservice coordination. The Air Force will continue to monitor open recommendations.

Spare parts requirements determination, although not specifically listed as part of the spare parts weakness, is recognized by the Air Force as a problem area. Last year, at our suggestion, the Air Force agreed to include the requirements area in its tracking and follow-up system. The following is a discussion of the effort to correct this area.

The Corona Require study on the aircraft replenishment spares requirements and computation process identified areas within the requirements process that needed improvement. Using the study, the Air Force developed 26 initiatives to respond to those areas. These initiatives are directed at

--modernizing data processing,
--managing weapon systems rather than items,
--simplifying and improving the accuracy of forecasts,
--creating a system to address unprogrammed requirements,
--enhancing the business strategy of buying spares, and
--balancing spares buys with other maintenance and supply activities.

The Air Force established a Corona Require Steering Committee to monitor the day-to-day actions taken on the initiatives. The Committee is comprised of officers from the air staff and is chaired by the Deputy Director of the Air Force Directorate of Logistics Plans and Programs. The Committee ensures that all areas of the study are addressed and monitors actions taken,

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relative to established milestones. It also approves the actions taken on the initiatives before they may be closed. In this year's annual assurance letter, the Air Force reported that 19 of the 26 initiatives had been implemented.

According to an Air Force official, the remaining initiatives were closed during February 1985. However, longer term data processing-related initiatives, while closed, are still being monitored by the Air Force.

We did not evaluate the Air Force Management Analyses Group or the Corona Require studies, nor did we evaluate the effectiveness of the actions resulting from them. The Air Force Inspector General evaluated the effectiveness of actions taken in response to the Analysis Group recommendations. However, we were unable to obtain or review the results of the inspection because it had not been completed at the time of our review.

We are reviewing the requirements data base initiatives that resulted from the Corona Require study. These initiatives relate to a computer-based acquisition and system development effort for support of the requirements computation process.

MATERIAL WEAKNESSES IDENTIFIED DURING THE SECOND YEAR

The Air Force identified seven material weaknesses during its second year effort. These included five from last year and two new ones. The new weaknesses and planned corrective actions, as reported by the Air Force, follow:

Weakness: Existing controls allowed the disposal of some assets applicable to current weapon systems.

The Air Force Inspector General reported that needed assets applicable to active weapon systems were being disposed of at both retail and wholesale levels. The report identified 20 recommendations and 58 actions to rectify the situation. In March 1984, all major commands were directed to immediately freeze the disposal of all assets applicable to active weapon systems. This halt allowed the Air Force to make systemic changes to data systems, policies, and procedures. For example, data automation requirements have been submitted and regulations are being rewritten.

The 58 actions are being individually tracked and reported by the Air Force Logistics Command, with periodic reports to the Commander and to the Deputy Chief of Staff for Logistics and Engineering, at Air Force Headquarters. The Air Force estimated that the 58 actions would be implemented by October 1985, and the disposal freeze would be lifted by March 1985.

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Weakness: Contract administration controls did not require the evaluation of a contractor's quality control system as part of normal contract administration duties for service contracts in all cases.

The Air Force Inspector General reported that contractor-provided quality control plans were of questionable value and were not being used by surveillance personnel because of a systemic control deficiency in the governing directive--Air Force Regulation 400-28. To correct this, the Air Force is changing the regulation to provide contracting officers more latitude in specifying what quality control plan requirements should be in a contract. In addition, the revised regulation will include more specific policies on government review and approval of the plan submitted by the contractor.

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APPENDIX III

CORRECTIVE ACTIONS TAKEN OR PLANNED BY THE AIR FORCE ON ACCOUNTING SYSTEMS DEFICIENCIES

The Air Force's annual report forecasts completion of eight corrective actions for its nonconforming systems by fiscal year 1991. In some cases, the Air Force is taking a long time to correct major problems it has known about for many years. On the other hand, it reports the completion of 11 corrective actions.

Regarding corrective actions taken, the Air Force reports, for example, that the departmental level Air Force Stock Fund was brought into conformance through the development and implementation of procedures necessary to provide the capability to record estimates of accounts receivable. The Air Force also reports that the military pay system was improved and brought into conformance with Comptroller General requirements through better management and reporting of advance payments and accounts receivable.

Two of the eight corrective actions still to be implemented are included in the Retiree/Annuitant Pay System upgrade project, which has an estimated cost of over $6.2 million. These changes will bring about improvements which will include better interface with other systems requiring annuity/casualty data, an accrual accounting system at the individual member account level, and a user management information system with documented internal controls. Changes to the pay system are forecasted for implementation by September 1986.

The other six planned corrective actions are not scheduled for implementation until the period October 1987 through 1990. Some of these corrective actions are taking a long time to implement. For example, in 1976 we brought to the Air Force's attention the need to improve its posting to the general ledger. This improvement is among the long-term improvements to the General Accounting and Finance System, forecasted by the Air Force for completion by 1991.

The 1984 Secretary of Defense annual FIA statement reports that the Air Force's General Accounting and Finance System will be brought into conformance during the first quarter of fiscal year 1988, a date not coordinated with the Air Force system planners. DOD and the Air Force should resolve differences in target dates and set the earliest achievable date for completing corrective actions and reaching system conformance.

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GLOSSARY

We developed the following definitions that apply to our review of the implementation of the Federal Managers' Financial Integrity Act.

Accounting System

The total structure of the methods and procedures used to record, classify, and report information on the financial position and operations of a government unit or any of its funds, balanced account groups, and organizational components. An accounting system should assist in the financial management functions of budget formulation and execution, proprietary accounting, and financial reporting.

ADP Application Controls

Controls that are unique to each software application system. Application controls are intended to ensure the quality of data origination, input, processing, and output.

ADP General Controls

Controls that apply to the overall management of the ADP function in an agency. General ADP controls have a direct effect on the quality of service rendered to ADP users and cover the processing of all ADP application systems. These controls affect most ADP hardware and application software systems, and include:

--organizational controls for the ADP unit;
--system design, development, and modification controls;
--data center management controls;
--data center security controls;
--system software controls; and
--hardware controls.

These controls should be evaluated by ADP managers as part of an analysis of the general control environment.

Comptroller General's Requirements

Our Policy and Procedures Manual for Guidance of Federal Agencies contains the principles, standards, and related requirements to be observed by federal agencies. Specifically, title 2 prescribes the overall accounting principles and standards, while titles 4, 5, 6, and 7 specify requirements governing claims; transportation; pay, leave and allowance; and fiscal procedures, respectively.

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Also, agency accounting systems must include internal controls that comply with the Comptroller General's internal control standards and related requirements such as Treasury Fiscal Requirements Manual and OMB circulars.

Documentation

That information which would allow an independent reviewer to understand the rationale for conclusions the reviewer reached regarding an agency's internal controls, as well as the methods used, and personnel involved. This information should be current and be available for review. "Documentation" of internal controls is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

Internal Controls

The plan of organization and all coordinate methods and measures adopted by an agency to provide reasonable assurance that the three objectives of the Federal Managers' Financial Integrity Act of 1982 are achieved. Internal controls should be established in accordance with the Comptroller General's Internal Control Standards. Typically, an internal control represents the combination of a control objective, along with a control technique (or set of techniques) that is being relied on to achieve that control objective.

Internal Control Review

A detailed examination of a system of internal control to determine whether adequate control measures exist and are implemented to prevent or detect the occurrence of potential risks in a cost-effective manner. OMB guidelines recommend six steps for an internal control review: (1) identification of the event cycle, (2) analysis of the general control environment, (3) documentation of the event cycle, (4) evaluation of internal controls within the cycle, (5) testing of the internal controls, and (6) reporting the results. Internal control reviews should normally be conducted for those areas rated as highly vulnerable in the vulnerability assessment process, where corrective action is not readily apparent. An agency should allocate resources for these detailed reviews of internal control based on vulnerability. Those most vulnerable should be reviewed first.

Internal Control Standards

The Federal Managers' Financial Integrity Act of 1982 requires each executive agency to establish internal accounting and administrative controls in accordance with,

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among other things, standards issued by the Comptroller General. In 1983, the Comptroller General issued a set of 12 Standards for Internal Controls in the Federal Government. The standards include five general control standards, six specific standards, and an audit resolution standard. The five general standards are: (1) reasonable assurance, (2) supportive attitude, (3) competent personnel, (4) control objectives, and (5) control techniques. The six specific standards are: (1) documentation, (2) recording of transactions and events, (3) execution of transactions and events, (4) separation of duties, (5) supervision, and (6) access to and accountability for resources.

Quality Assurance

The process(es) or system(s) of an agency which provide(s) reasonable assurance that the internal control evaluation, improvement, and reporting process established in accordance with the OMB guidelines is carried out in a consistent, accurate, and reliable manner. These processes or systems will form part of the basis for the annual assurance letters and statement to the President and the Congress. An agency's quality assurance has several essential elements, including appropriate documentation for the internal control evaluation process; appropriate Inspector General role in the process; adequacy of resources and overall organization of the process; appropriate training for managers with internal control responsibilities; and assuring that actions taken will correct weaknesses permitting fraud, waste, or mismanagement.

Reasonable Assurance

Internal controls systems should provide reasonable, but not absolute, assurance that the objectives of the system will be accomplished. This concept recognizes that the cost of internal control should not exceed the benefit expected to be derived therefrom, and that the benefits consist of reductions in the risks of failing to achieve stated objectives. Estimates and judgments are required to assess the expected benefits and related costs of internal controls. Errors or irregularities may occur and not be detected because of inherent limitations in any internal control, including those resulting from resource constraints, or congressional restrictions. "Reasonable Assurance" is one of the Comptroller General's Standards for Internal Controls in the Federal Government.

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Segmentation

The process by which an agency identifies assessable units; that is, its programs and administrative functions. The inventory of assessable units developed as a result of this process must be appropriately detailed so as to provide a basis for the conduct of meaningful vulnerability assessments. OMB guidelines provide that all the agency activities, except those concerned with policymaking, should be included in the inventory. There is no single best method to segment an agency, particularly in light of variations in agency organization structure and responsibilities.

Testing Systems in Operation

Testing should be conducted on all critical system aspects and may include interviewing persons who operate the systems, observing operating procedures, examining system documentation, applying procedures on live transactions and comparing results, direct testing of computer-based systems by use of simulated transactions, and reviewing error reports and evaluating error follow-up procedures. Tests should be designed to disclose whether valid transactions are processed properly, and whether the system rejects invalid transactions. The tests should cover the entire transaction--from initial authorization through processing, posting to the accounts, and reporting. Accordingly, manual as well as automated operations should be included. In developing test plans, consideration should be given to the results of any prior system testing.

This testing criteria has been adopted by OMB and included in Appendix H of its publication, Guidelines for Evaluating Financial Management/Accounting Systems (May 20, 1985). In determining the tests that would be appropriate for any system, it is important to keep in mind that in most cases, using transaction testing as the key, more than one of the above techniques are needed to test all important aspects of an accounting system.

Vulnerability Assessment

A biennial review of the susceptibility of an assessable unit to the occurrence of waste, loss, unauthorized use, or misappropriation. OMB guidelines prescribe three basic steps for the conduct of vulnerability assessments: (1) analyze the general control environment, (2) analyze the inherent risk, and (3) perform a preliminary evaluation of existing safeguards. The primary purpose of vulnerability assessments is to determine if and in what sequence resources should be allocated for the performance of internal control reviews.

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APPENDIX V

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

COMPTROLLER

16 SEP 1985

Mr. Frank C. Conahan
Director, National Security and
International Affairs Division
U.S. General Accounting Office
441 G. Street, N.W.
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Final Letter Report (GAO/NSIAD-85-116, OSD Case 6814)Draft Reports, "Department of Defense's Implementation of the Federal Managers' Financial Integrity Act (FMFIA)," dated July 29, 1985 (GAO Code 390017, OSD Case 6809), and related reports to the Military Departments (GAO Codes 390018 through 390020, OSD Cases 6810 through 6812) and the Defense Logistics Agency (GAO Code 390017, OSD Case No. 6813).

The DoD is pleased that the GAO acknowledged the Department's progress in successfully implementing the FMFIA. At the same time, the GAO expressed reservations as to whether the DoD had an adequate basis for reporting that the objectives of the FMFIA had been met. The GAO's reservations may be more a result of its limited evaluation criteria than uncertainties in the IMC process. Whereas the GAO generally relied on its criteria in assessing reasonable assurance, the DoD used its complete network of management systems and audits.

The DoD will continue to improve its guidance for the annual evaluation of accounting systems. The DoD, however, also will continue its view that the accounting systems provide adequate internal and fund control features and that the certified systems are in compliance with GAO accounting requirements, unless detailed audits prove otherwise. Along these lines, on May 23, 1985, the DoD issued an advance copy (to be finalized in September) of guidance requiring testing of accounting systems to assure that prescribed accounting requirements are satisfied.

Specific DoD comments on each of GAO's findings and recommendations are enclosed. The DoD appreciates GAO efforts in assisting the DoD to meet the requirements of the FMFIA. Thank you for the opportunity to comment on the draft reports.

Sincerely,

John R. Quetsch

John R. Quetsch
Principal Deputy Assistant Secretary of Defense
(Comptroller)

Enclosure

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GAO DRAFT REPORT - DATED AUGUST 9, 1985
(GAO CODE 390019 - OSD CASE 6812)

"DEPARTMENT OF THE AIR FORCE'S IMPLEMENTATION OF THE FEDERAL MANAGER'S FINANCIAL INTEGRITY ACT (FMFIA)"

DOD COMMENTS

* * * * *

FINDINGS

o FINDING A: Air Force Has Made Progress In Identifying And Correcting Material Weaknesses; However, Significant Deficiencies Exist GAO found that the Air Force has worked to correct the 5 material weaknesses reported in 1983. GAO reviewed progress on 3 of the reported weaknesses: Foreign Military Sales (FMS) billing; FMS delivery reporting; and spare parts pricing. GAO found that the solution to the FMS billing and delivery reporting depends upon the implementation of a management information system, and the success of Air Force efforts in spares acquisition requires changing DoD regulations and public law. GAO concluded that these problems are complex and will require years of effort. Since 1983, GAO noted, Air Force has reported progress toward bringing its accounting systems into conformance with the Comptroller General's requirements--reporting 25 of 28 systems in conformance, an increase of 3 from 1983. GAO noted the 3 systems not conforming are: the General Accounting and Finance System; the Central Procurement Accounting System, and the Retiree/Annuitant Pay System. The Air Force, according to GAO, forecasts completion of changes to the Pay System by September 1986, and other corrective actions during the period October 1987 through 1990. GAO concluded that, while the Air Force has made progress in strengthening its internal controls, significant deficiencies persist and therefore, it does not have an adequate basis for determining that the requirements of the act have been met. (Pages 1-7, and 28)

DoD Response: Partially concur. As indicated by the GAO, continuing progress is being made to correct identified material weaknesses and to make the necessary changes to the three remaining accounting systems to bring them more completely into conformance with the Comptroller General's requirements. Although material weaknesses do exist as reported in the previous annual statements, the overall management control program has been strengthened, and in conjunction with other management reviews, the efforts provide an adequate basis for determining that the requirements of the act have been met.

Note: Where applicable, pages numbers have been changed to correspond with this report.

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o **FINDING B: Progress And Problems In Determining The Status Of Internal Controls And Accounting Systems Conformance.** GAO noted that in its report last year (OSD Case 6468) it identified several improvements necessary to enhance the comprehensiveness and quality of various elements of the Air Force internal control and accounting systems compliance evaluation process. GAO found that during 1984, the Air Force made some of the suggested improvements; Air Force (1) separated and improved the segmentation and vulnerability assessment (VA) phases, (2) provided training and detailed guidance on how to perform and document VAs, Internal Control Reviews (ICRs) and accounting system reviews, and (3) was more specific about the material weaknesses reported. GAO also found that Air Force has improved its process: FY 1984 guidance was more definitive and stringent; accounting systems review coverage was increased and documentation requirements were set; responsibility for internal control and accounting systems evaluation guidance was consolidated; and a corrective action tracking and followup system and target dates for completing corrective actions were established. GAO further found, however, that 4 areas still need improvement:

-- Documenting and/or performing VAs and ICRs (testing internal controls for compliance), including conducting more effective quality assurance evaluations of ICRs.

-- Addressing ADP general and application controls.

-- Completing a comprehensive accounting systems inventory.

-- Testing accounting systems in operation.

GAO concluded, therefore, that the Air Force internal control and accounting systems evaluation program had not matured to the point where it could provide an adequate basis for determining the requirements of the FMFIA had been met. (Pages 7-13)

DoD Response: Partially concur. As noted by the GAO, improvements were made in the FY 1984 internal control and accounting systems evaluation process. These improvements enhanced the comprehensiveness and quality of that process. Further enhancements were made in the FY 1985 program. These included further training of program managers during FY 1985, issuance of DoD ADP guidelines in March 1985, completion of a comprehensive accounting systems inventory in March 1985, and issuance of testing instructions to program managers in January 1985. Consequently, the DoD disagrees with the conclusion that the Air Force internal control and accounting systems evaluation program has not matured to the point where it could provide an adequate basis for determining that the requirements of the FMFIA had been met.

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- **FINDING C: Better Performance And Documentation Of Internal Control Reviews Is Still Needed.** GAO reported that Air Force took steps to improve its ICRs through training and issuing detailed guidance on how to perform and document an ICR. GAO reviewed 24 ICRs and found, however, that 15 were inadequately documented and 8 were inadequate because internal controls were not compliance tested. GAO also found that the majority of the base-level reviewers, for the 24 cases examined, were not adequately trained to perform an ICR. GAO noted that the Air Force Audit Agency found similar problems--systemic reviews were not always performed, review methodology was not always documented and quality assurance was not provided over major command and base level reviews, and base-level reviewers were untrained. GAO concluded, however, that the Air Force FY 1985 evaluation program guidance addressed these problems and resulted in improvements. (Pages 8-9)

  DoD Response: Concur. As noted by the GAO, additional training was provided to MAJCOM program managers and the problems identified by the GAO were addressed in the FY 1985 guidance to the field. The GAO is correct that ".... the Air Force FY 1985 evaluation program guidance addressed these problems and resulted in improvements."

- **FINDING D: Better Consideration Of ADP Internal Controls Is Still Needed.** GAO noted that last year it reported better coverage of the Air Force ADP controls was needed and, in response, the Air Force issued supplemental guidelines. GAO found, however, that the supplemental guidelines were received too late to be incorporated into the 1984 ICRs. GAO also found that, even though the guidelines were issued late, commands were required to evaluate ADP application controls and report to the Comptroller by October 15, 1984. GAO further found that the guidelines did not cover controls such as software design, development or testing, data processing facility security and hardware controls. Therefore, in spite of the Air Force effort, GAO concluded that the guidelines were inadequate. Further, GAO found that at least 3 commands, including the Air Force Logistics Command, did not evaluate controls at all. Therefore, GAO also concluded that the Air Force did not adequately assess ADP controls during the FY 1984 evaluation. GAO finally concluded that, if Air Force adopts the OSD ADP internal control guidelines, attention to ADP in the FY 1985 ICRs should improve. (Page 10)

  DoD Response: Concur. The information systems functional area adopted the DoD ADP Internal Control Guidelines and issued a copy of it to information systems offices Air Force-wide. The same guidelines were issued through the Cost and Management Analysis (ACM) channels. Through the

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use of the DoD guidelines, the Air Force FY 1985 ICRs have improved.

o **FINDING E: Air Force Had Insufficient Basis For Reporting 25 of its 28 Systems As Substantially Conforming With Comptroller General Requirements And That Its Systems Satisfactorily Support Fiduciary And Management Accounting Responsibilities.** Noting that DoD instructions require a complete accounting systems inventory to be developed and verified, GAO found that Air Force's current inventory of 28 accounting systems is not complete, e.g., the Acquisition Management Information System is not included. GAO also found that the Air Force plans to evaluate its systems on a 5-year cycle, and stated that the cycle appeared reasonable. GAO found, however, that Air Force did not test its systems in operation as part of the 1984 evaluations. Therefore, because testing is necessary to determine whether an accounting system conforms to the Comptroller General's requirements, GAO concluded that the Air Force accounting systems evaluation program did not provide an adequate basis to assure conformance to the FMFIA despite Air Force's programs. GAO also found no evidence to support the Air Force statement that its nonconforming systems have financial control and reporting features and they satisfactorily support the Air Force fiduciary and management accounting responsibilities. GAO concluded that the Air Force should conduct an analysis to support such a claim. GAO pointed out, however, that in January 1985, Air Force provided new instructions containing provisions for testing, and requiring the cooperation of functional and data automation personnel in performing the test. (GAO noted that it will evaluate the adequacy of the new instruction in future reviews.) (Pages 10-13)

DoD Response: Nonconcur. The Air Force had sufficient basis for reporting that 25 of 28 systems were in substantial conformance with Comptroller General requirements and that all 28 systems satisfactorily support fiduciary and management accounting responsibilities. There was full disclosure on the three systems not in conformance. The Air Force strictly followed OMB guidelines and DoD guidance which provided the framework and procedures for developing the basis for the annual statement. In addition to specific accounting systems conformance reviews, many related reviews were made under Section 2 of the act. Evaluation of all review results were supplemented by externally developed information such as Audit/IG reports and discrepancy reports developed during normal operations at over 100 field offices. Although it did not include transaction testing of live operations, this collective effort provided sufficient confidence in the integrity of the systems stated to be in conformance. Additionally, it should be noted that GAO had previously approved the design packages for all but three

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systems and had approved the fund control aspects of these three systems. During DoD reviews, there was no evidence, nor any indication, that any nonconforming systems did not satisfactorily support financial and management accounting responsibilities.

RECOMMENDATIONS

- **RECOMMENDATION 1:** GAO recommended that the Secretary of the Air Force not report the Air Force's system of internal accounting and administrative control as meeting the requirements of the FMFIA until the internal controls evaluation program is improved. (Page 14)

  DoD Response: Nonconcur. The DoD Internal Management Control Program is a relatively new, evolving and improving program. However, the current program is adequate to assure the Secretary that the Air Force system of internal accounting and administrative controls meets the requirements of the FMFIA. This system includes internal control reviews, vulnerability assessments, review of IG, Audit, and Investigative reports, and general internal self-inspection program at the installation level.

- **RECOMMENDATION 2:** GAO recommended that, to form an adequate basis for determining the requirements of the FMFIA have been met, the Secretary of the Air Force direct the Comptroller to ensure:

  -- managers who perform vulnerability assessments and Internal Control Reviews are adequately trained;

  -- ADP general and application control reviews are incorporated into Internal Control Reviews;

  -- OSD ADP Internal Control Guidelines are included as part of the Air Force's guidance and approach for consideration and evaluation of ADP internal controls;

  -- responsible officials at all levels of the organization effectively perform their quality assurance responsibilities;

  -- an inventory of accounting systems is properly completed; and

  -- appropriate manual and ADP accounting systems controls are tested in operation as an integral part of the evaluation process. (Pages 14-15)

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DoD Response: Concur. The Air Force has implemented these actions during FY 1985. Specifically, the Air Force has:

a. Provided enhanced training to MAJCOM program managers who were then tasked to train their counterparts at the installation level.

b. Included ADP general and application controls in the information systems functional area ICRs.

c. Included the DoD ADP Internal Control Guidelines as part of the guidance and approach for consideration and evaluation of ADP internal controls.

d. Stressed quality assurance in the FY 1985 guidance sent to the field. The draft revision to Air Force Regulation 170-22 further stresses quality assurance responsibilities and will be sent out for Major Command comments in September 1985.

e. Completed a comprehensive inventory of accounting systems. Systems identification statements for over 130 separate candidates were submitted by elements throughout the Air Force and the audit community on or before October 1984. The inventory was finalized with the participation and concurrence of virtually all Major Commands during a March 1985 FMFIA workshop at the AFAFC. This effort completed the inventory process which identified 29 standard or major accounting and financial systems and 81 unique or support accounting and financial systems.

f. Distributed additional testing instructions to all Major Commands in January 1985. The development of test plans considers results of any prior system testing. Systems test plans in the Air Force are an integral part of the process of bringing systems to "on line' operation. Typically, 10-15 percent of systems development costs are associated with testing. The Air Force performs exhaustive transaction testing, both in-house and in the field, before a system is implemented. In addition, whenever a significant modification of a system is implemented, required testing of that modification tends to revalidate the entire system. Testing techniques of observation, interview, and examination of documentation are essentially ongoing processes in the Air Force. The FY 1984 Internal Control Review Program included tests of the General Accounting and Finance Systems, Military Pay, Civilian Pay, and Materiel Management systems. Furthermore, Air Force published instructions require additional transaction testing whenever deemed necessary to attain reasonable assurance as to the conformance of the system being reviewed. This degree and methodology of testing was consistent with existing guidance and

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direction. The cost associated with increased or additional systems testing (over and above that being accomplished) likely would be prohibitive in relation to substantive benefit. Further, the GAO April 18, 1983, letter to all agencies stated that the GAO would test live operations during the system approval process. Such testing should further guarantee that the Air Force systems remain in conformance.

- **RECOMMENDATION 3:** GAO recommended that accounting systems not be reported in conformance with the Comptroller General's requirements, nor that nonconforming accounting systems satisfactorily support fiduciary and management accounting responsibilities until the Air Force accounting systems have been adequately evaluated and tested in operation. (Page 15)

DoD Response: Nonconcur. The Air Force had sufficient basis (refer to DoD comments to Finding E) to determine that its accounting systems were in conformance with Comptroller General requirements and that all systems satisfactorily supported fiduciary and management accounting responsibilities. No evidence to the contrary has been found and, as indicated by the GAO, the Air Force fully disclosed all (three) known accounting systems problems. When a system is designed in accordance with existing requirements, exhaustively tested, maintained, and reviewed periodically with acceptable to excellent results, the system must be considered in conformance unless proven otherwise. Interpretation of available guidance indicated sufficient information about a system must be available to the agency to have "reasonable assurance" that the system conforms with requirements in all material respects. The Air Force's annual statement will continue to be based on this premise. Evaluation of supplementary information continues to improve each year and provides additional confidence for developing the annual statements on conformance. OMB guidelines and DoD guidance will continue to be followed to assure adequate evaluations each year. Reviews under Section 2 of the act will be coordinated when practicable to enhance the overall evaluation efforts.

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